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President & Chief Executive Officer

AFFINITY FEDERAL CREDIT UNION

March 30, 2009

Ms.Mary Rupp, Board Secretary
National Credit Union Administration
Alexandria, Virginia 22314-3428

Re: Affinity Federal Credit Union's Response to the NCUA Advanced Notice of Proposal Rulemaking

Dear Ms. Rupp:

Thank you for the opportunity to comment on the above mentioned proposed rule making. The world economic/financial crisis of 2008 and 2009 provides an interesting backdrop for and creates a new sense of urgency to affect changes to the credit union system. However, like any crisis situation, changes and solutions must be viewed from a long-term perspective, both from the sense of what got us to this point as well as where we are headed. With that being said, for more than 30 years the Corporate Credit Union network has provided value to its ownership, Natural Person Credit Unions. Affinity Federal Credit Union has been one of those beneficiaries fully needing and utilizing the core and ancillary products and services provided by Corporates. While it is clear that other providers exist outside of the credit union system, the need for Corporates is rooted in the cooperative nature of credit unions. The not-for-profit perspective of our segment of the financial services industry allows us to place service and value creation before profit to stakeholders. This uniqueness affects the effects of commoditization inherent in financial services and allows Natural Person Credit Unions to pass this on to our end users, credit union members.

At the same time, this differentiation is a benefit; it can also place tension on the primary source of capitalization earnings.

The current global economic and financial crisis has certainly amplified the inherent problems associated with capital accumulation in our cooperative credit union model. It has also distracted us from the underlying benefits of the Corporate Credit Union network that continues to serve all credit unions. Affinity Federal Credit Union does not deny there are things that need to change and improve the corporate credit union part of our system; in fact, we are proponents and change activists. However, our first point urges balance between what are extraordinary stresses and effects of a historic crisis and what are systemic changes dictated by the evolving financial community, which we need to make in an orderly longer-term fashion.

The past year's market events and their impact upon corporate credit unions have awakened a complacent system, but knee jerk reactions can have many unintended consequences. Clearly, the NCUA had to take action in January 2009 to protect liquidity and instill confidence in the system. However, these actions were necessitated by accounting principals intended to disclose possible future events in "normal" markets instead of the outcome we witnessed which forced

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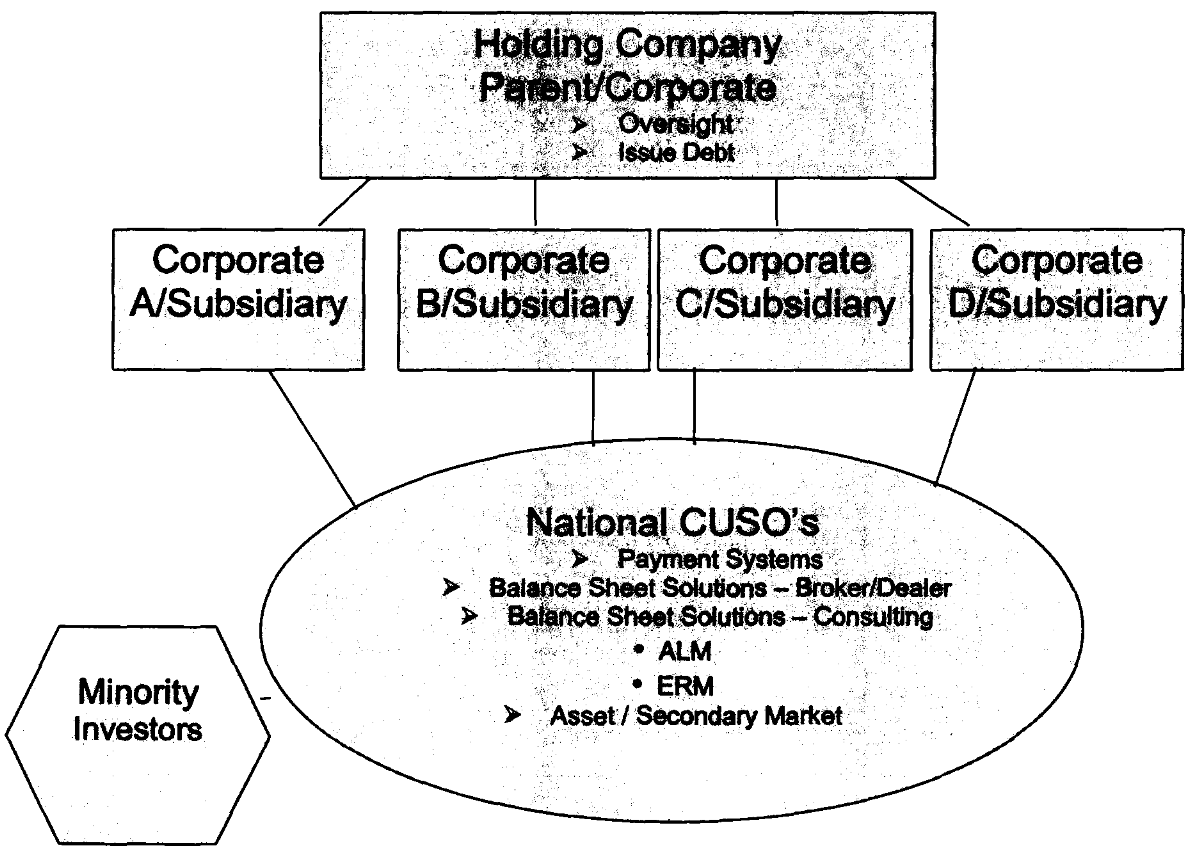
future potential losses to be recorded long before their probable occurrences. The difference between possible and probable based on somewhat subjective assumptions needs to be given more careful review, especially given the fact that credit unions, Corporate and Natural Person Credit Unions, have no outside investors and stockholders who are the intended audience for GAAP founded principles like fair value pronouncements. For many years, credit unions were recipients of qualified audit opinions because we classified shares as equity not liabilities. It may be time again for credit unions to accept qualified opinions rather then to subject our members to unwarranted losses.

Corporate Credit Unions are wholesale providers of products and services yet, like the retail sector Natural Person Credit Unions, they are intermediaries. This means that funds move through Corporates, money in and money out, and you cannot separate that process. For example, Corporate Credit Unions are liquidity providers. That liquidity is vital to other services such as payment systems and the settlement process associated with Natural Person Credit Union member transactions. While there is a level of risk associated with each segment of this process, this risk cannot be mitigated by having a separate payment system without the liquidity side of the equation. In fact the risk of system failure is much greater if payment functions are separated from liquidity. We urge NCUA not to attempt to isolate these other services in an attempt to separate the risks. Instead we believe that these risks can be better managed by structural changes and we recommend the following structure:

Structure



The corporate system should be collapsed to a single tier with the establishment of a Corporate Credit Union holding company with 3 to 5 subsidiary Corporate Credit Unions strategically located throughout the country. This structure would allow better control of concentration risk associated with a single Corporate. Since the needs of Natural Person Credit Unions differ by size and business models shaped by member/consumer needs, the individual subsidiary Corporates can offer variations of product offerings to meet cooperative needs by what fits a specific Natural Person Credit Union's needs or by regional needs and variances or even by a Corporates style for how they provide service. The main advantage of the structure is that the "parent"/holding company move capital and/or liquidity through the subsidiary system as necessary, thereby mitigating risks such as concentrations of assets and liabilities affected by different economic or geographic cycles. Unlike the structure today, where US Central acts as an aggregator and, for some smaller, risk adverse Corporates, as the back office function, the parent holding company would have no balance sheet of its own other then through subsidiary accounting consolidation. The parent holding company would only have an oversight role and act as a mechanism for ensuring proper subsidiary levels of liquidity and capital based on economic cycles, geographic factors and other subsidiary level market forces. This would be accomplished by limiting the ability to issue debt only to the holding company Corporate based on an aggregate risk profile, not the subsidiaries and their individual risk profiles. The subsidiaries would operate similar to the Federal Home Loan Banks system from the perspective of joint and several liabilities.

Operationally, the holding company's expenses would be paid for through administrative assessment fees charged to the subsidiaries. The Boards of Director's for each subsidiary Corporate would be elected from the natural person credit union membership through by-laws created by those members. The holding company Corporate would have a Board made up of at large directors employed at natural person credit unions, but separate from the subsidiary Boards.

Payment Systems

Payment systems have become a core service for Corporates evolving from items processing and settlement functions. All financial institutions including Corporates are money movers. Corporates have always managed payment risks well and Affinity believes that Corporates must offer payment and settlement services. However, these services are volume driven, meaning the more the volume, the better the economies of scale and efficiencies will be. To that end, we recommend the creation of a national payment system CUSO. This CUSO would be majority owned by the holding company and its subsidiaries. A key responsibility of the corporate owners of the CUSO would be to ensure 'best practice' operations including redundant back up and hot sites capable of assuring business continuity at near 100% availability for all services offered.

The pressing issue related to payments is a Corporates ability to fund settlement associated with the payments services it provides. This is effectively a subset of the overnight and intra-day settlement and liquidity risks that Corporates incur by being in the settlement services business. A corporate settles many classes of transactions including the payments it operates, payments others (e.g. Federal Reserve, banks, League Service Corporations, independent processors) operate, deposits and associated dividends, loans and associated payments, etc. The ANPR asks whether the payment services should be isolated from other services to separate the risks. Affinity Federal Credit Union believes that settlement of payments cannot be effectively separated and should be addressed in a broader context than just payments. This issue is addressed further under "Liquidity and Liquidity Management" below.

The redundant corporate payment operations limit corporate profitability, slow capital accumulation, and inflate fees to members. The fragmented nature also limits incremental and radical innovation, while the limited (regional) markets often make new products infeasible because required scale cannot be achieved. We recommend consolidating corporate payments, and potentially those of some other credit union-owned payment operations, to better serve credit unions. Though this consolidation would require several years and considerable expense to complete, the long-term strategic and financial benefits to the industry would be significant.

Corporates must fully understand all material risks to capital and should allocate an appropriate portion of their capital to all business lines (e.g. deposits, lending, settlement services, and payment services). All remaining subsidiary Corporates must be CUSO owners.

Liquidity and Liquidity Management

Liquidity must continue to be a core service of the corporate network. Corporates have historically managed liquidity risks well through many difficult economic cycles and we must remember that there is a major historical global financial crisis that is severely testing even the best liquidity plans. Surely, Corporates must establish new plans, liquidity strategies and modeling based on 2008 and 2009 events. Corporates will also need to create the systems for moving liquidity through the new proposed corporate network, including the national payments CUSO.

The Corporates are the primary financial institution (PFI) for most credit unions. To maintain this relationship, Corporates must offer full lines of account services, settlement services, payment and correspondent services (regardless of whether they are operated or distributed by Corporates), and short-term and intermediate-term investment and lending options. Eliminating any of these offerings reduces the Corporates value as the cash management provider and risks losing the entire relationship to non-corporate providers.

To effectively manage liquidity, Corporates must have adequate measurement and reporting processes. To the extent Corporates' processes are inadequate to properly assess their cash flows; regulators should require improvement under best practices and other guidance. Applicable methods include:

- Cash flow GAP modeling across prepayment ranges
- Limits on illiquid asset classes
- Limits on readily liquid assets and cash (minimums)
- Development of requirements for diversified funding sources
- In-depth contingency funding plans

Corporates' liquidity plans have been effective during many difficult economic cycles. The recent crisis has underscored several best practices that should be employed (e.g. multiple borrowing sources, adequate cash reserves to cover unexpected short-term liquidity swings).

Best Practices that should be 'required' are noted below.

- Require modeling of liquidity plans for typical fluctuations in economic cycles
- Require Corporates to set aside a portion of liquidity to specifically fund daily settlement. The set-aside must accommodate the timing of settlement of debits and credits as well as the daily, monthly, and annual cyclical activity levels. The allocation must be clearly identifiable from other activity and reserved for settlement only.

- Stress liquidity plans by modeling performance under more dramatic scenarios and adjust liquidity requirements/sources accordingly.
- Require provisions to increase existing or add new sources of liquidity if limits are hit. One such tool may be to secure member balances as the primary source of liquidity for settlement services and allow the required level of deposit to be adjusted under extraordinary circumstances (such as what the market is currently experiencing). For example, require members to maintain a settlement account balance equal to 1 to 1.5 times a credit union's average or peak historical settlement activity. This is a common practice by some Corporates today. The contingency plan may include triggers that increase this requirement to 1.5 or 2 times the average or peak activity in order to ensure adequate liquidity to continue settlement.

The CLF has proven to be an invaluable tool for the NCUA throughout the credit and liquidity crisis. However, the agency has encountered legislative barriers that prohibited or hampered their efforts to effectively address the crisis. Conduct a comprehensive evaluation of the CLF and advocate for changes that improve it as a tool for use by the NCUA and the industry.

Field of Membership Issues

Competition is a healthy thing yet the corporate network, and the credit union system as a whole, is too small and needs to have greater internal cooperation in order to succeed. In other words, we need to greatly reduce internal system competition and better focus on the real external competitors who offer the same products and services we do.

We believe the structure we propose, (holding Company of subsidiary Corporates), will require national fields of membership to accommodate the transfer of risks throughout the system. This would, in essence, create a "preferred Corporate" option for Natural Person Credit Unions.

Governance principles might include:

- Require perpetual membership capital for a credit union to obtain services from one of the subsidiary Corporates
- Standardize capital requirements so that Corporates do not compete over credit unions by lowering required capital levels
- Allow Corporates to vary rates on perpetual membership capital to help build capital, then reward owners for financial performance of the corporate once minimum capital targets are met
- Allow limited portability of membership by permitting a credit union to sell their perpetual capital in one corporate and join another corporate (contributing perpetual capital to the new corporate). Include restrictions required for the perpetual capital to qualify as GAAP Tier 1 capital. Require Board of Director approval so that a corporate does not experience a catastrophic loss of capital if a group of credit unions changed during the same period. Govern unforeseen occurrences by requiring NCUA approval of such migrations.
- Enable Corporates to distribute other Corporates' investment and lending products, for a fee. This would allow credit unions to diversify investments and liquidity sources across multiple Corporates without fostering the fierce competition that currently exists
- Allow credit unions to directly diversify their investments and liquidity sources by establishing one or more relationships with "secondary" Corporates. The credit union would be allowed to obtain select services (term investments, term loans) by depositing

three-year term membership capital shares in proportion with the level of services utilized. Pricing of these products would be no better than what a "primary" member could obtain (to reduce competition for diversification services)

Expanded Investment Authority

The current expanded investment authorities are appropriate and did not cause or contribute to the current paper losses. Today the NCUA correctly correlates the eligibility and limits for expanded investment authorities with capabilities. There needs to be more definitive guidance for capital requirements relative to the level of expanded authorities. Capital levels should be the foundation requirement for additional authorities thus requiring this enhanced guidance.

Corporates are only allowed to purchase highly rated securities and have well-defined guidance for risk exposure. Regulation and guidance have evolved with the financial markets and have proven adequate prior to the current extreme credit and liquidity crisis.

Corporates use expanded authorities to increase investment options (for both diversification and yield), create product offerings, mitigate risks (using derivatives), and facilitate member liquidity by participating in member loans. The tools have valid applications, and the competition outside the Corporate Network has these tools available to them. The question should be whether the corporate has appropriate expertise, systems, processes, and controls to utilize the tools effectively and safely.

The agency currently grants specific authorities and sets limits based upon a Corporates capital, risk profile, and ability to utilize the tools effectively and safely. Access to expanded authorities requires significant investment in staff, systems, and process development. The bar is already set very high; adjust it as needed.

Corporate Capital

The current global crisis belies the need for greater amounts of core capital as defined as GAAP Tier 1 Capital. NCUA should require a minimum core capital level equal to 4% by the end of 2010. That level should then be raised to at least 6% thereafter.

RUDE should be sufficient to accommodate growth, recognizing that this would be applied over longer time horizons since this would vary depending on ROE and ROA projections.

We believe that the calculation of actual capital divided by 12 months Daily Average Net Assets, DANA, is appropriate and necessary due to the daily fluctuations of a liquidity provided by Corporates.

NCUA should establish a risk-based capital requirement for Corporates, which would foster a more thorough assessment of risks and the assignment of appropriate capital to those risks. NCUA must mandate the contribution of capital by the users of the Corporates, it should never be voluntary. In addition to limiting service to the level of capital contributed, NCUA should create provisions allowing this capital to be allocated to the corporate network by the holding company corporate as necessary.

NCUA must mandate capital contributions for all credit unions that use the Corporate network. This Capital would be in the form of Core Perpetual GAAP Tier 1 capital. NCUA should allow

Corporates the option of offering non-core capital in order to fund additional products, services and growth. It would be permissible for individual Corporate Boards to declare dividends at their discretion. NCUA may also want to consider a system wide capital assessment for all natural person credit unions, regardless of Charter type or whether a credit union uses the Corporate network, to further enhance the long-term safety and soundness of our cooperative system.

Credit unions need to diversify their portfolios. Enabling diversification across Corporates meets this need, adds to the aggregate liquidity of the corporate network, and accelerates capital accumulation within the network. Two structures would accomplish this:

- Allow Corporates to distribute other Corporates' term certificates and term lending as brokered transactions. Limits would govern how much a corporate could distribute through other Corporates in order to limit dilution of that Corporates capital and temper competition among Corporates. Corporates should not be able to set rates for certificates and loans distributed by other Corporates higher than what the issuing Corporates own members can obtain. This, plus a brokerage fee paid to the selling corporate, will temper competition
- Allow credit unions to directly diversify their investments and liquidity sources by establishing one or more relationships with "secondary" Corporates. The credit union would be allowed to obtain select services (term investments, term loans) by depositing three-year term membership capital shares in proportion with the level of services utilized. Pricing of these products would be no better than what a "primary" member could obtain (to reduce competition for diversification services)

Permissible Investments

The very nature of Corporate Credit Unions as wholesalers and aggregators requires different investment authorities then those of natural person credit unions. Credit unions often use investments as an alternative to loans in periods of economic weakness or to more efficiently utilize excess liquidity (usually a small percentage of their total balance sheet.) Corporates, in their role as liquidity providers, should be solely focused on the liquid and shorter-term investment products. Credit union balance sheets carry investments primarily for cash/liquidity management, based on much smaller positions. Therefore credit union needs for a wide range of permissible investments, level of investment expertise, and extent of investment and risk infrastructure differs substantially from that of Corporates. Credit union infrastructure and expertise is understandably more extensive and appropriately allocated to member lending activities. Whereas corporate balance sheets, which represent primarily investment of credit unions' liquid assets, need a wider range of short-term investment alternatives along with more extensive investment and risk management infrastructure and expertise.

Clearly, the investment market place is crowded with investment types, such as CD's, CDO^2, CDO, NIM's, etc., that should not be permissible at all. Some currently authorized types should also be subject to conditions such as a more stringent review process. Other investment types where the volatility of credit risk is leveraged through structure (e.g. when a 10% change in volatility results in a 100% change in the underlying risk posture) should be prohibited. Examples of investment types that should be prohibited or conditioned include long-term interest-only strips, long-term principal-only strips, and some types of leveraged floaters and inverse floaters.

Historically, there has been rapid development of investment types. Corporates were typically able to enter these investments on their own. There needs to be some process to effectively evaluate these new investment types in a timely manner before they are brought onto corporate balance sheets. Ideally, this review should be performed or validated by a qualified third party and/or the NCUA staff. This is particularly important if diversification/sector standards are initiated, as new asset classes will be seen as an attractive way to meet such diversification/sector requirements.

Credit Risk Management

If there were ever anything wrong and in dire need of major rehabilitation, it is credit risk management. At the top of the list is fixing the national rating agencies by, first and foremost, only allowing them to be compensated by the purchaser, not the issuer. It should also be required that multiple agencies should be used in the decision process with variances analyzed and validated. There should be a regulatory review process for all new security types and there needs to be limits on duration or cash flow structures. Most importantly, NCUA must better define and control concentration limits. This can be a slippery slope as maximum diversification targets may actually increase risk if you are forced to diversify into riskier classes of securities just because you reached a predetermined maximum level of concentration. We recommend optimum concentration targets instead of maximum targets.

Asset Liability Management

Corporates operating under expanded authorities already perform ALM at rigorous levels. Best Practices for ALM would now dictate reassessing modeling assumptions based on the current market dislocation and the widening of credit spreads.

Corporate Governance

Corporate Credit Unions will continue to be financial cooperatives owned by its members. Governance should be representative of its membership and should never consist of outside directors. Boards should be permitted by NCUA to use outside governance consultants in order to gain additional insights or expertise. Board members and committee members should remain unpaid volunteers with required, certified training. The governance process should require annual peer reviews at a minimum. Boards of directors should be permitted all aspects of Board governance, including term limits and the only regulatory requirement should be that the policies be formalized and reviewed by legal counsel.

Other Issues

Transparency: as member owned cooperatives, Corporates as well as the regulator, NCUA, must be held to greater transparency standards. For Corporates this transparency should include an annual report of investment and risk functions and a monthly publication of financial, portfolio and risk positions.

National Asset CUSO

The current global credit crisis has certainly emphasized the need for a more controlled environment for managing the higher quality assets found in this unique financial industry segment called cooperative credit unions. The credit union system has always been plagued by anemic market share as it is forced to sell its assets outside the credit union system to effectively manage individual credit union balance sheets.

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Credit unions, given their overall membership characteristics relative to statutory field of membership requirements, have historically had higher underlying credit quality in virtually all assets on its books. This is truer today than ever as demonstrated by the majority credit unions loan performance compared to other non-credit union financial industry participants.

That being said, it is time for the credit union system to develop and operate an outlet process that allows individual credit unions, natural person and Corporates, to move assets on and off their books as they effectively manage balance sheets for optimum performance and risk mitigation.

The outlet process would require the formation and capitalization of another national CUSO majority owned by Corporate Credit Unions with permissible minority investors allowed by regulation.

This national asset CUSO would act as other secondary market makers do, outside the credit union system today. The Asset CUSO would purchase any type of asset, mortgage loans, consumer loans, business loans, etc., and the CUSO would then have multiple options available to manage these assets such as selling them to other credit unions, participating them with individual or multiple credit unions, securitizing them and offering the securities to investors, primarily including credit union investors including the subsidiary Corporate network or the holding company proposed above. The CUSO could also elect to hold them in their own portfolios.

This Asset CUSO structure would reduce the individual credit union and systemic system risk that is affecting us today and would enable the entire system to act independently of the rest of the financial services industry and thus insulating the credit union system from the types of mass meltdown we are experiencing today.

Affinity would be happy to provide a more detailed analysis and Business Plan for this Asset CUSO concept.

Thank you for the opportunity to comment and allowing Affinity to engage in the process.

Sincerely,

Affinity Federal Credit Union

John Fenton
President and Chief Executive Officer

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